RIVER ESTATES SDN. BHD.

v.

THE DIRECTOR-GENERAL OF INLAND REVENUE

PRIVY COUNCIL
LORD SCARMAN
LORD ROSKILL
LORD BRIDGE OF HARWICH
LORD BRIGHTMAN
DENYS BUCKLEY
[APPEAL NO. 19 OF 1982]
5 DECEMBER 1983

REVENUE LAW: *Income tax - Additional assessment - Whether appellant entitled to set off capital allowance for timber operations - Whether appellant was engaged in one business or more - Source of income.*

The appellant had been engaged commercially in the extraction of timber and in plantation in north-east Borneo since 1950. In 1973 the Inland Revenue Department served upon the appellant notices of additional assessments to income tax, a total sum of RM1,964,586 for the assessment years of 1968-1972.

The additional assessment arose from the refusal of the Revenue Department to accept that during the relevant period the appellant was entitled to set off capital allowances in respect of qualifying plantation expenditure against income derived from its timber operations. The revenue department submitted that such allowances were available only against income derived from the appellant's plantation operations. However, the appellant appealed to the Special Commissioners of Income Tax.

The question to be determined was whether, during the relevant period the appellant carried on one single business of which timber extraction and plantation were integral parts or whether it carried on more than one business.

The Special Commissioners of Income Tax found that during the relevant period the appellant carried on three businesses, namely: a plantation business embracing their three estates, and two separate timber extraction businesses. On appeal, the High Court upheld the view of the Special Commissioners. The Federal Court held that the appellant carried on two businesses - a plantation business and a timber extraction business.

Held:

[1] The question presented to the Special Commissioners for their determination was a question of fact.

[2] The difference of opinion between the Special Commissioners who held that there were three businesses and the Federal Court who found there were two separate businesses, is immaterial.

[3] The order of the Special Commissioners is affirmed and the additional assessment by the Revenue Department stands.

[Appeal dismissed. Appellant to pay costs.]

Cases referred to:
Edwards v. Bairstow and Harrison [1956] AC 14
Scales v. George Thompson and Company Limited [1927] 13 TC 83

Legislation referred to:
Income Tax Act 1967, ss. 4, 5, (1)(c), (2), 42, 43

For the appellant - D.C. Potter QC (S. Woodhull with him)
For the respondent - Stewart Bates QC (Stephen Allcock with him)

JUDGMENT

Lord Scarman:

Ever since its incorporation in 1950 River Estates Sdn. Bhd., the appellant, has been engaged commercially in the extraction of timber and in plantation in North East Borneo. On 15 December 1973 the Director-General of Inland Revenue ("the Revenue") served upon the appellant notices of additional assessment to income tax for the years of assessment 1968-72. The assessments were:

1968	RM	431,112
1969		356,253
1970		1,019,229
1971		90,790
1972		67,202

The appellant appealed against the assessments. The appeal was dismissed by the Special Commissioners of Income Tax, by the High Court and by the Federal Court. The case now comes before Your Lordships' Board with the leave of the Federal Court.

The assessments arise from the refusal of the revenue to accept that during the relevant period the appellant was entitled to set off capital allowances in respect of qualifying plantation expenditure against income derived from its timber operations. It is the revenue's submission that in the circumstances of this case the plantation allowances are available only against income derived from the appellant's plantation operation. The case turns on whether during the relevant period (i.e. the basis periods of the years of assessment) the appellant carried on one single business of which timber extraction and plantation were integral parts, or whether it carried on more than one business. It was, and remains, the revenue submission that the appellant during this period was engaged in two businesses, plantation (which would include timber extraction necessary to clear an estate for planting) and the separate business of timber extraction in forest areas where there was no planting.

The point arises under s. 42 of the Income Tax Act 1967. The section defines "statutory income", which is a stage in the statutory process of converting gross income arising from a taxpayer's source or sources of income into the total taxable income from all his sources. So far as is material to the issue in this appeal, the section provides that:

> ... statutory income (if any) of a person **from a source** for a year of assessment shall consist of
>
> (a) the amount of his adjusted income (if any) **from that source** for the basis period for that year ...
>
> reduced by the amount of any allowance or the aggregate amount of the allowances falling to be made for that year under ... Schedule [3] **in relation to that source.**
> (emphasis supplied).

Schedule 3 sets out the expenditure which qualifies for allowance in reduction of income under s. 42. Plantation expenditure on the works specified in paragraph 7 of the schedule qualifies. Paragraphs 20 to 24 contain detailed provisions regulating plantation allowances. Paragraph 75 provides for the case where there is an insufficiency or absence of income of a person "... **from a business of his** ..." for the basis period for a year of assessment. If effect in full cannot be given to the allowance (or allowances) for that year, the unabsorbed amount of allowance may be carried forward to subsequent years of assessment "... for which there is ... income **from that business** ...". The schedule does not authorise setting off allowances in respect of one business against income arising from another business.

Certain features of the law are clear. The law uses the concept of "source" in the determination of income: ss. 4 and 5 of the Act. A business is, if it shows a profit, a source of income, and, if it shows a loss, a source of loss: s. 5(1)(c). The statute recognises the existence of a source consisting of a business and the situation that a taxpayer can have more than one source consisting of a business: s. 5(2) and s. 43. Plantation allowance is available to reduce taxable income arising from a source consisting of a business which includes plantation: s. 42 and schedule 3, which relate allowances to a specific source and to income from that source. They are limited to income from that source: s. 42. If unabsorbed, they are available against subsequent income from that business source: but there is no provision permitting their use for reducing taxable income from other business sources.

The Special Commissioners found that during the relevant period the appellant carried on three businesses:

> a plantation business embracing their three estates, and two separate timber extraction businesses. The High Court upheld their view. The Federal Court held that the appellant carried on two businesses - a plantation business and a timber extraction business. One need not inquire whether the Federal Court was entitled to take a different view from the special commissioners as to the number of businesses carried on by the appellant: for it does not matter to the decision of the appeal. The appellant's case is that there was one business only. If that case fails, appellant's Counsel concedes that the assessments must stand. All Courts below were, therefore, agreed upon their answer to the critical issue: they held that during the relevant period the appellant carried on more than one business.

Much thought was given by the Courts below to the question whether one business could include several sources of income. The Special Commissioners decided that it could and so held in respect of the appellant's plantation operations, which they found to be one business with three sources of income, namely the three estates where it was carried on. The High Court and the Federal Court accepted this analysis. The appellant, however, has before their Lordships' Board argued for the view "one business - one source", i.e. that a taxpayer having only one business has only one source of income consisting of a business, even though the business itself may cover many different commercial operations. The importance of this view to his case is that under s. 42 allowances are available only if they fall to be made in relation to the source of income which is sought to be reduced. The point, however, does not arise for decision in the appeal, and their Lordships, having heard no argument from the respondent, express no opinion upon it.

Their Lordships agree with the Federal Court that the question presented to the Special Commissioners for their determination was a question of fact. Was the appellant carrying on one or more than one business? Counsel for the appellant accepted that it was for them a question of fact. The error of law, into which he submits that they fell and which, he submits,

the Courts on appeal have so far failed to correct, was that their determination, i.e. that the appellant was carrying on more than one business was such that no reasonable tribunal, directing itself correctly in law, could have reached it. He relied on *Edwards v. Bairstow and Harrison* [1956] AC 14 and in particular on the passage (p. 36) in Lord Radcliffe's speech which, having been received into the law as a classic: no longer calls for quotation or paraphrase.

Counsel's argument for the appellant before the Board was, therefore, addressed to this question. He derived some help from the test applied, admittedly in a different context upon different facts, by Rowlatt J in *Scales v. George Thompson and Company Limited* [1927] 13 TC 83 at page 89:

> ... was there any inter-connection, any interlacing, any interdependence, any unity at all embracing those two businesses?

He submitted that upon the facts as found by the Special Commissioners the uniting factors (pointing to one business embracing the appellant's plantation and forestry operations) were so overwhelming as to contradict the determination that there were two (or more) separate businesses. In the words of Lord Radcliffe he submitted that the true and only reasonable conclusion upon the facts was that the appellant carried on one business embracing all its various plantation and forestry operations.

Their Lordships recognise that the appellant had a formidable case to present to the Special Commissioners. Now that the Commissioners have decided against it, can it be said that the appellant's case was the true and only reasonable conclusion upon the facts and that the Commissioners' determination, by contradicting it, erred in law? Because the question merits serious attention their Lordships find it necessary to summarise the facts before stating their conclusion.

The appellant was incorporated in the former British colony of North Borneo in 1950 and commenced business that year. Its head office was at all material times at Sandakan in north-east Borneo. Upon incorporation the appellant acquired two properties, the Litang and the Bode estate. They were acquired for plantation. The Bode estate was disposed of in 1955 and does not call for further consideration. The Litang estate, on the Sungei Segama, was in part planted with rubber but also included an area of virgin jungle. The appellant conducted logging operations in the jungle which, when cleared, was planted with rubber, cocoa and oil palms. The timber extracted was sold. Litang was in production as a plantation through out the years with which the appeal is concerned.

In 1952 the appellant secured a government licence to carry out timber extraction in virgin jungle on state land at Dagat. The appellant acquired no land. It logged between 2 and 3 square miles of jungle each year under an annual licence until 1957 when it was granted a 21 year licence. This timber operation still continues and has produced substantial profits: during the years 1967 to 1971 (which are included in the basis periods of the challenged assessments) gross sales of timber amounted to about $5million a year.

When the appellant first entered Dagat, its managing director had seen the area as having a potential for plantation. In 1967 the appellant applied for an alienation, i.e. a transfer from government ownership, of some 10,000 acres of the detimbered land for development as a banana estate. A banana nursery was established on some 4 or 5 acres. The project came to nothing, the State Government not being prepared to lose a 10,000 acre block from the Dagat forest reserve. The banana plantation idea was abandoned. But the appellant continued, and continues, its timber operations in the area under government licence.

In 1959 the appellant purchased the Malubok estate. The land was largely jungle. The appellant extracted the timber, cleared the jungle, and planted cocoa and rubber. In 1963 serious floods devastated a substantial area of plantation. The Government would not alienate additional land for which the appellant applied. After extracting the marketable timber the appellant abandoned the area.

In 1961 the appellant acquired a substantial acreage of jungle some 5 miles distant from the eastern boundary of Litang. Extraction of timber was followed by the planting of oil palms in the cleared area, which became known as the Tomanggong estate. The appellant obtained further land in 1969, by which time it had established a factory for extracting and processing the palm oil. The operations at Tomanggong still continue.

In 1965 the appellant entered into a contract with another company to log for that company the Tenggara area in the Kretam Forest Reserve. The appellant acquired no land. It was paid at an agreed rate per cubic foot of logs delivered to the company with which it was under contract. The contract terminated in 1969.

The direction and management of the appellant's operations were centralised at head office. All senior executives were planters. The estate and camp managers and other subordinate staff were moved from estate duties to timber operations, and vice versa. Plant and machinery, if usable both in planting and logging, were moved around as needed. Stores were centrally purchased. Financial control was at head office. Cash for wages and other purposes was provided from head office. Detailed records were kept by estate and camp managers, monthly returns being made to head office where a working account was kept for each estate and camp. Balances were transferred annually to a head office set of accounts, which included an overall profit and loss account and balance sheet.

Upon these facts the Special Commissioners concluded that the appellant's operations at the Litang, Tomanggong and Malubok estates, which included logging as well as plantation, "constituted a single business because the logging operations on those estates were a pre-requisite to planting". They found that the timber operations at Dagat where no land was acquired and no plantation established were a separate business from that carried on at the three estates, Litang, Tomanggong and Malubok. Finally, they concluded that the logging contract operation at Tenggara was a separate business not only from that of the three estates but also from that of Dagat.

The centralised control of the appellant's operations and the interchangeability of senior executives and staff between plantations and forestry areas strongly suggest one business. The geographical spread, to which some attention was paid by the Special Commissioners, who considered it a factor in favour of separate businesses, was, their Lordships think, a "neutral" fact (see Lord Radcliffe *supra* at p. 36): certainly it was not inconsistent with one business. But was it unreasonable of the Special Commissioners to decide that these were separate businesses? In their Lordships' opinion it cannot be said to have been so. The difference between the forestry operations when not directed towards clearing land for plantation and the plantation estates was real and substantial. It cannot be denied that the two types of operation could be included in one business: equally, they could be separate businesses. Either conclusion being open to the Special Commissioners, it is difficult to assert that either conclusion is the "true and only reasonable conclusion". Moreover, their Lordships attach importance to the view of the High Court and the Federal Court that the conclusion in favour of separate businesses was a reasonable one. The appellant's point of law, therefore, fails.

The difference of opinion to which reference has already been made between the Special Commissioners who held that there were three businesses (that of the three plantations, the Dagat timber extractions under licence, and the logging under contract at Tenggara) and the Federal Court who found there were "actually two separate businesses" (the plantations and the timber operations) is immaterial, as Counsel for the appellant correctly conceded. Had it been necessary to decide the point, it might well have been necessary to consider whether the Federal Court was entitled to substitute its view on what they saw as a question of fact for that of the Special Commissioners.

In the result, therefore, the order of the Special Commissioners must be affirmed and the additional assessments must stand. Their Lordships will advise His Majesty the Yang di-Pertuan Agong that the appeal ought to be dismissed. The appellant must pay the respondent's costs.

Also found at [1984] 1 CLJ 21